

MINUTES
REGULAR MEETING OF THE BOARD OF LAND COMMISSIONERS
Monday, October 17, 2005, at 9:00 a.m.
State Capitol Building, Room 303

PRESENT: Governor Brian Schweitzer, Attorney General Mike McGrath, Secretary of State Brad Johnson, and State Auditor John Morrison

Voting via telephone: Superintendent of Public Instruction Linda McCulloch

Motion was made by Mr. Johnson to approve the minutes from the regularly scheduled meeting of the Board of Land Commissioners held September 19, 2005. Seconded by Mr. McGrath. Motion carried unanimously.

BUSINESS TO BE CONSIDERED

1005-1 FWP – ROBERTSON CREEK ACQUISITION/LOWER FLATHEAD RIVER

Glen Erickson, Field Services Administrator – FWP, said we are proposing to acquire a little over two acres of land along the Flathead River, the lower four miles of that river outside the Reservation. This particular parcel is private land and has been used as a launch site for many years both for hunting and fishing access. The last couple of years it has been closed to the public. We worked with the landowners and they agreed to sell the property to FWP for \$180,200. We will be using fishing access site funding, fishing license dollars to buy the property. It was appraised at \$170,000 and we're paying more because they agreed to keep the site open while we complete negotiations. As you all may know, the 72 miles of the Flathead River are important for Northern Pike and small mouth bass fishing. The access site is supported by several different groups, the Montana Bass Federation, the Flathead Chapter of Walleyes Unlimited, and also the Eastern Sanders County Conservation District. We have talked to the Confederated Salish and Kootenai Tribes and they also support of the access at that point. We submitted a draft EA on the property and received seven comments all in support. The decision notice was issued on September 20th and the Fish and Game Commission approved the acquisition on October 6, 2005. Mr. Erickson requested approval from the Board.

Motion was made by Mr. Johnson to approve the Robertson Creek Acquisition. Seconded by Mr. Morrison. Motion carried unanimously.

1005-2 REINSTATEMENT OF LEASE NOS 721 AND 8569

Mary Sexton, Director DNRC, said this is for reinstatement of two leases, Andrew Jackson Sons Partnership located in Richland County. This is similar to one the Board heard last month where there was some unauthorized sub-leasing. The lessees were notified and a letter was sent by the department recommending a penalty of \$348. If this is paid the lease will be reinstated at the previous terms and conditions. That is our recommendation.

Motion was made by Mr. McGrath to approve the reinstatement of lease Nos. 721 and 8569. Seconded by Mr. Johnson. Motion carried unanimously.

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1005-3 APPROVAL OF ADMINISTRATIVE RULE FOR ROYALTY RATES

Ms. Sexton said this comes from the approval by the Board for the increase of royalty rate to 16.67% and drafting of corresponding rules. That process has been completed and now we are recommending consideration and approval to implement the proposed amendment to ARM 36.25.210 and the approval of the 16.67% royalty rate. Or, if the Board doesn't want to approve the rules at this time, it can approve the royalty rate for the December's oil and gas lease sale, much as it did in September. We've gone through the rules process and there were two comments. One from the Montana Petroleum Association and one from the Northern Alliance of Independent Producers. Again, the option for the Board is to either approve the rules and the increase in the royalty rate or it needs to approve the royalty rate for the December lease sale.

Dave Galt, Montana Petroleum Association, said we are here today to change the royalty rate for oil and gas leases on state lands in Montana by administrative rule. The MPA testified on August 15th when the Board raised the royalty rate issue and I am not here today to change our position on any of those comments but to emphasize the last sentence that Gail Abercrombie made. The MPA believes that state land leases should offer more options, not just a higher rate and no increase in speculative areas. Both North Dakota and Wyoming have a process that helps foster exploration on undeveloped state land, and we think Montana should do the same. I've talked with Mr. Mason and understand the reluctance on his part to adopt a system like North Dakota, however, Wyoming has a mechanism that we suggest you modify and adopt in Montana.

In Wyoming, the state offers leases for nomination at a 1/6 royalty rate. If the nomination does not get any bids the lease is re-auctioned at an 1/8 royalty rate. The MPA offers an option like Wyoming. The MPA suggest that you allow nominations that did not receive any bids to go to the person who made the nomination for 1/8 rate. I have submitted in my handout a proposed amendment that would accomplish that task. In Montana persons interested in a state lease nominate the land. If there are no bids at the auction, then the person nominating the land gets the lease at the existing royalty rate. MPA's suggestion would be easy to administer and it would offer incentive to innovative people in the oil business to explore unproven sections of state land. It is the kind of determination and innovation that led the recent successful play in Utah. America's easy oil reserves, the low hanging fruit, have been produced. Today's areas are more difficult and consequently more expensive, that's why it is so important for Montana to remain competitive if we hope to continue to attract oil and gas exploration and production. The MPA is concerned that Montana will revert to a higher tax state and see reduced oil and gas exploration. I spoke with numerous people in the oil and gas industry in preparation for this testimony and I found it interesting how far out they budget for exploration. In many cases they budget 12-24 months in advance of actually buying any leases. Keep this in mind, that these companies decide where to budget their resources and the total tax picture in the state weighs heavily on that decision. Therefore, it may take several months before a trend is recognized. While September was one of the highest revenue-producing sales, it also had the largest number of leases that went for minimum bid in 2005. According to Mr. Mason, the September sale has 205 leases of which 20 went for minimum bid. The MPA understands and respects your responsibility to maximize the revenue for the school trust. It is a fact that about 85% of the land leased does not have producing wells on them. The revenue stream to the state is much greater for producing wells than simply lease revenue. The MPA proposal allows a small percentage of state land to be leased at a lower rate of 1/8. I can see that such a change will drastically change the bidding strategy in the auctions when we know that a parcel that does not get a bid will go for a lower rate. One last point, on one hand you could say why reduce the rate when they are going well at 1/6, on the other hand, we

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will never know how many unexplored and unproven parcels will not be nominated at the higher 1/6 rate, does not have enough room for speculative exploration.

Ed Bartlett, Attorney for Northern Alliance of Independent Gas Producers, said the Northern Alliance has members and producers of both oil and gas in Montana, North Dakota, and South Dakota. The Northern Alliance did submit comments both to the department and to the Land Board asking that the Board not adopt this increase and new rule, and the Board reconsider it's August decision. I was told by Mr. Mason this morning that my client on late Friday afternoon withdrew his request for a public hearing. My client did not contact me to indicate that decision. Personally, I think further consideration and deliberation by this Board is necessary before it adopts this rule. The reason is many fold, but most importantly in my mind is what you do on behalf of policy for this state sets the norm and the standard. I have to agree with the implications Mr. Mason has put forward in the record so far and also agree that what happened in September was correct. But I also agree with the Petroleum Association. The long term effect is what is important, not what happened at a particular sale. In my opinion, and in the opinion of my client, the long term effect of this increase is detrimental to the State of Montana and its policy. It puts Montana in a less competitive position and by doing so, the long term effect will be negative. On behalf of my client, I ask this morning is the Board reconsider its earlier decision and give more deliberation to this proposal.

Governor Schweitzer said you represent the oil and gas industry and presumably you can tell me what is the rig count in Montana right now? How many rigs are drilling in Montana?

Mr. Galt said last time I checked there were 34.

Governor Schweitzer asked and would you be able to tell me how many were drilling 24 months ago?

Mr. Galt replied no.

Governor Schweitzer said my guess is its about 1/3 of that or less.

Mr. Galt said I would guess that oil production in Montana is up.

Governor Schweitzer said the price of oil 24 months ago when these decisions, as you describe, these decisions were made, the price of oil 24 months ago was plus or minus what a barrel?

Mr. Galt said it was less than it is today.

Governor Schweitzer said yes, and maybe half, \$30 - \$35 per barrel, that range?

Mr. Galt said I don't know what the range is.

Governor Schweitzer said how about natural gas? What would have been the price 24 months ago when the decisions were made to go ahead with drilling? It was maybe worth 35-40% of what it is today?

Mr. Galt said I am sure.

Governor Schweitzer said so we managed a rig count from 10 – 35 in the environment of 24 months ago and if that's the description, they made their decisions 24 months out, just imagine where we'll be 24 months from now when decisions are made based on \$55 per barrel and \$25 per mcf for gas. Let's

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compare tax policy. Does North Dakota or Wyoming have the first 18-month holiday on drilling? In other words, in Montana to bring the rig count up we made this decision 5-6 years ago, we said Alberta, North Dakota, and Wyoming all have a higher rig count that we do, so we gave an 18-month holiday for paying taxes during the first part of the oil and gas well coming in. Does North Dakota or Wyoming have a similar tax law?

Mr. Galt said I don't know.

Governor Schweitzer said they don't. I was in Wyoming looking at coal bed methane last week with the Governor of Wyoming and some industry folks. They have 8,000 coal bed methane wells. We were comparing tax policy and they found out with CBM and with the horizontal drilling that we're doing right now we don't get any revenue for the first 18-months. They were dumbfounded. They said to me, in our technology when you first drill the well, during the first 12-20 months is when you get the greatest gas production. It takes six to seven months to pump the water to get the pressure off and then the gas comes. There is a pretty steep decline. So it appears in the case of CBM there is a lot of revenue that the State of Montana doesn't get. Our tax policy is much lower than they have in Wyoming and North Dakota yet they build 8,000 CBM wells in Wyoming. It also seems to me that since they are at 1/6 and I know that Wyoming's is such that it is at 1/6 unless they don't get a bid then they go to 1/8, I think we discussed this and said we will go to 1/6 and if we see that our revenues are going down we will make another decision and go back to 1/8. The Board has considered not only what other states were doing around us, what our tax policy was versus theirs, what our current environment was, and it is great news to hear from you today that these decisions about drilling or not drilling were done 24 months ago when the price of gas was 35% and the price of oil was half. So it seems to me we've got some good sales in front of us if those decisions are made based on the current environment. If we see that we are decreasing our revenue, that rig counts are falling, if the interest in drilling in Montana is markedly less than it is elsewhere, I would be the first to ask the Board to reconsider this decision. But based on the information you have provided us this morning, that it is 24 months out when these decisions are made, I would say there is a lot more drilling in the pipeline based on today's current prices. I know that our tax policy is much better than North Dakota's or Wyoming's because I mentioned CBM and some of you would say but we don't drill a lot of CBM yet in Montana, probably lower reserves and we haven't started with as big a bang as they did in Wyoming so let's talk about oil.

Where our big production of oil is coming in right now is in the Williston Basin. We also have the Cedar Creek Anticline and the stripper production, those are old wells, but let's talk about horizontal drilling. We've had an opportunity to witness over the last two years some of the largest producing oil wells in the history of this state. I was in Sidney last week and visited with the Mayor of Sidney. He said now in the Williston Basin they've got the oil so structured with horizontal drilling that before they set the rig up they already start laying the surface pipe to the location. Because they know when they get to that pay zone with horizontal drilling they will get a good pay, its 90%. Dry holes are not a big issue now in the Williston Basin. With horizontal drilling the reason we are able to get such large wells is we have markedly decreased the time it takes to recover the oil in that zone. Instead of putting one pipe and having oil flow to it from as much as 2,000 feet away, we have a pipe that goes to the pay zone and then we go horizontal in several directions so we are effectively able to drain that zone much faster. With the 18-month holiday, it means Montana is getting a lot less revenue then they are in Wyoming and North Dakota. We want to be competitive, we want to attract the oil and gas industry to come into Montana but it seems to me based on my comparison of tax rates in North Dakota, Wyoming, and Montana, we have the lowest taxes in the region. If we find 12-24 months out that the decisions they make today are

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affecting the number of bids and the amount of money we are getting for the bids I think this Board is prepared to readdress where we are.

Mr. Johnson said from a purely mechanical sense within the workings of the department, would this amendment work as proposed?

Mr. Mason said I have not seen the amendment. It has not been presented to the department. [Mr. Mason quickly reviewed the amendment presented by Mr. Galt.] As proposed this could be implemented without any additional work on our part because what the amendment does is advise us that even though we have an applicant who has, by his nomination, guaranteed he will take the lease at the minimum, which is offered at 1/6, even though he has guaranteed that, we will offer him a lease at the lower rate. So we would just be merely changing the rate that was advertised in the sale, that he committed to, to the lower rate when we issue the lease. It would not cause any problem.

Mr. Morrison said in the absence of this amendment, how would the bidding be handled if there was not a bidder at the asked rate?

Mr. Mason said there is a bidder. The nominee, the applicant, submits his application. In that application there is a requirement that if nobody else bids higher than him at the sale, he is guaranteeing he will take the lease at the minimum rental. If somebody bids above him, he does not have to match that higher bid, but he is already the bidder who will take the tract at the minimum. That's the way it is set up in administrative rule and in our process. We take great pains to remind them during the process that there is a period of time before the lease sale when they can withdraw their bid. At one point prior to the lease sale when the applicant list and the final bid list have been advertised and everything is set, when they know what stipulations will be attached to their lease, then at that point they no longer have the option of withdrawing. We take great pains to make sure they are aware of that.

Mr. Johnson said it is my understanding that there is a fundamental difference in process between Montana and Wyoming and that is in Montana parcels are generally nominated by individuals while in Wyoming parcels are generally nominated by the state. Is that an accurate understanding on my part?

Mr. Mason said yes, I believe it is.

Governor Schweitzer asked how does Wyoming know there is an interest in certain parcels? Does private industry contact them and say we have an interest? They don't actually nominate it but clearly they are turning loose a township for leasing. There must be some kind of a system that is prompted by private industry because I don't think Wyoming has an oil and gas exploration division within the state.

Mr. Mason said there is an nomination process but the details between that and what shows up at the lease sale I don't have an answer for that. I can certainly find out.

Governor Schweitzer said we want to make sure that in our business we are not markedly higher or lower than the private industry. Can you give me an idea of what the private industry is paying for leases in terms of the percentage when they are leasing it across the oil and gas zones in Montana?

Mr. Galt said it varies depending on the area, anywhere from 1/8 to more than 1/5 in places that are high. I don't know what the average is.

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Motion was made by Mr. McGrath to adopt the revised royalty rate. Seconded by Mr. Morrison.

Mr. McGrath said we would be willing to reconsider down the road if it looks as though we are not competitive or were creating problems with markets in Montana that don't exist in our neighboring states. But I do think under our trust obligations we are required to be competitive and we should bring in the rates that are brought into other states. If you compare our taxes with theirs, I think we are lower than those other states overall in terms of revenues that the people in Montana get. Secondly, I was concerned that we didn't have a hearing. I am very concerned about adopting a rule without more elaborate discussion and I think it is a bad idea to have a policy that says we are going to have a 1/6 rate but then agree on the side that if there is only one bidder, the nominator is the only person that may get a lower rate after they have already agreed to pay 1/6. I am not sure that is a fair process to members of the public. I think if we were going to have such a rule it needs to be a more elaborate amendment so the language is consistent and people who are contemplating a bid understand what the situation is they are going to get into. I thought we were going to have a hearing on this and consider this next month and that would have given us more time to work that language out. But, as the Governor said, we can always reconsider these so I am going to vote to approve it as it is.

Mr. Johnson said I don't hear anyone here proposing that we roll back the 1/6 level on the vast majority of leases. I am not sure the amendment and proposed rule are mutually exclusive in any way, my concern here has to do with what would be a very small fraction of parcels that would be put up for bid. If, in fact, this option created by the amendment would cause potential nominators to nominate any small number of additional parcels that wouldn't be nominated otherwise, I think it is a worthwhile endeavor because I would rather have a 1/8 of something than 1/6 of nothing. And that is really the alternative. I would move the adoption of the amendment as proposed.

Governor Schweitzer said that would be a second motion and it requires a second to it. Seeing none, it leaves the motion we have on the table. Once again, since it appears we have a lower tax rate than our neighbors in North Dakota and Wyoming, and it appears, furthermore, that 24 months ago there were decisions made based on prices of gas and oil that were substantially lower than we are today, that our rig count has multiplied at as great a percentage as it has in history. Clearly we want to attract responsible oil and gas development in Montana but we also have an obligation to maximize our revenue. Mr. Johnson makes a valid point, the more land we can get bid, the more likely it is we will get it drilled. Under the current circumstances where we have a lower tax rate than our neighbors I think that we have an obligation to raise the maximum amount of revenue. I am prepared to go with this motion and if we see, again, as Mr. Galt suggested, 12-24 months out from this decision we start to see a decline in bidding or a decline in the value of these bids, we can address this at any time. This is open for the Board to address it at anytime in the future. I think that is what we talked about before and I am prepared to continue to support this motion.

Mr. Johnson said the only problem is we will never know about that small percentage of lands that were never nominated. There is no way to gauge that.

Mr. Morrison said as a practical matter if you want to bring an issue like this forward in the future, bring it to the department first and vet it through the department rather than bringing amendments to the Board.

A vote was taken on the motion on the floor. Motion carried unanimously.

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1005-4 PRELIMINARY APPROVAL FOR LAND BANKING PARCELS

Ms. Sexton said this is seeking preliminary approval for three land banking parcels. This is unique, there are three high value parcels in Chouteau County associated with the Strand Ranch totaling 800 acres. These were lessee nominated and went through the process in January during the nominations. We are bringing it forward now because of the need for more high value parcels. What we are requesting is approval for these with the caveat that they will be dropped if they do not appraise for a minimum of \$1,000 per acre. This is in Chouteau County where values are changing rapidly. After preliminary approval is granted, the department will get the appraisals done and do the cultural surveys, but they will not be sold unless the appraisal comes in for \$1,000 per acre or more.

Governor Schweitzer said do you know are these parcels of the Big Sag Ranch?

Ms. Sexton said it belongs to the Strand Brothers. I believe so.

Governor Schweitzer said its Dean Strand's place at Geyser then?

Ms. Sexton said in Chouteau County it is 20N R11E. It borders very close to Judith Basin County.

Governor Schweitzer said is there some water associated with this?

Ms. Sexton said there are some creeks that run through part of it.

Governor Schweitzer said the idea here is that we've had a lot of nominations on lower value lands and we are looking for some higher value lands?

Ms. Sexton said yes. For high value lands, we've only nominated 965 acres. In order to gather enough income to go out and purchase properties, we need more high value to balance that out. Making the properties that we have nominated \$150 – \$200 range.

Governor Schweitzer said based on your discussions you believe there is a chance that this would appraise at \$1,000 per acre?

Ms. Sexton said that's correct.

Motion was made by Mr. McGrath to grant preliminary approval to the purchase land banking parcels. Seconded by Mr. Johnson. Motion carried unanimously.

The Board considered the next three proposed timber sales collectively.

1005-5 MANLEY LIMITED ACCESS TIMBER SALE

Ms. Sexton said this is a limited access sale where we have an opportunity to get into some trust lands to which we don't have access otherwise. The adjacent landowner has agreed to allow Eagle Stud Mill limited access to the property for the purpose of timber harvest until October 15, 2006. This is 655 MBF on 82 acres with an estimated value of \$149,613.77. The department and Eagle Stud Mill negotiated a price of \$35.87/ton plus a Forest Improvement Fee of \$2.63/ton. The proposed project will capture the

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value of trees killed by Douglas-fir bark beetle and reduce the risk of further mortality by thinning the stand densities to healthier stands. Selective harvest, shelter wood and commercial thin treatments are being used. There will be .75 miles of new road construction and 1.13 miles of road reconstruction. There is no old growth on this parcel.

1005-6 TYLER CREEK TIMBER SALE

Ms. Sexton said this is 13 miles west of Drummond, and proposes to harvest from 359 acres. The estimated volume is 15,236 tons and the prescription is primarily designed to address the outbreak of Douglas-fir bark beetle and mountain pine beetle. Access is across existing roads, there will be 2.7 miles of new construction. All roads accessing the sale and all new roads will be closed to the public behind an existing locked gate. There is some old growth, approximately 440 acres, of those 216 acres will be harvested. There will be 110 acres that will fall out of the *Green et al* classification because there will be seven trees per acre rather than eight trees per acre. The old growth trees are being targeted because of beetle attacks on large trees.

1005-7 EWING MIDDLE RIDGE TIMBER SALE

Ms. Sexton said this proposed sale is 5 miles NW of Olney and proposes to harvest 8,568 tons with an estimated minimum value of \$195,350. The prescription is primarily to salvage and recover dead and dying trees that have been attacked by insects and disease. There is no old growth in this proposed sale. There are seven miles of existing road and it will be reconstructed or improved to meet BMP standards. Roads that are currently closed to the public will remain closed.

Motion was made by Mr. Morrison to approve the three proposed timber sales. Seconded by Mr. Johnson. Motion carried unanimously.

The Board addressed the next two requests for communitization agreements collectively.

1005-8 REQUEST FOR APPROVAL OF COMMUNITIZATION AGREEMENT
(Petro-Hunt, LLC)

Ms. Sexton said this is located in Richland County and is for a spacing unit of 1,203 acres. The department has almost ½ interest in this, and this will be at the 13% royalty rate because it was leased before the change. This is in the Bakken Formation.

1005-9 REQUEST FOR APPROVAL OF COMMUNITIZATION AGREEMENT
(Nance Petroleum Corporation)

Ms. Sexton said this is in Roosevelt County and is for a spacing unit of 640 acres or which the department's tract comprises 50% of the communitized area. This brings together small tracts sufficient for granting of a well permit under applicable spacing rules. This is in the Ratcliffe Formation. The department would receive 6.5% of all oil production because this is done under the old royalty rate.

Ms. Sexton requested approval of the communitization agreements.

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Motion was made by Mr. Johnson to approve the two communitization agreements. Seconded by Mr. McGrath. Motion carried unanimously.

1005-10 PINNACLE GAS RESOURCES – DIETZ CBNG WELL DRILLING APPLICATIONS

Ms. Sexton said Pinnacle has proposed a plan of development for the Dietz area which lies northeast of the existing CX field. The Dietz phase includes one state tract in T8S. The proposal consists of the drilling and completion of 161 coal bed natural gas (CBNG) wells with 137 fee wells and 24 state wells. They will be drilled on one well for 80 acres of coal seam. The state tract will be co-located on eight pad sites throughout the section. Three wells will be drilled on each pad site in order to develop and produce from the three specific coal zones. The method of disposal of the water will be through evaporation pits and also some proposals for stock water usage. An EA was released for public comment on September 9 and was extended through October 10. There were a number of comments from the Tongue River Water Users.

Bobbi Jo Coughlin, DNRC petroleum engineer, said this is very similar to what was presented as an informational item last month. We released the EA concurrently with the informational item. We received one set of comments from the Tongue River Water User's Association. There will be four evaporation pits on state land, all of them will be lined, all will be off-channel. There will be four evaporators per pit, there will be one storage pond off-channel used primarily during winter months when the evaporation rate isn't as high. All the water that is produced on state land will be managed on state land we will not be bringing water from fee wells onto state land for management, they will be managed independently of that. Some of the comments received don't necessarily relate to the project itself. There are some water issues concerning infiltration. There should not be any infiltration, the pits are all lined and all off-channel. There was an issue of accumulation of salts, a high SAR. Again, the pits are lined that is the primary management option Pinnacle will be using. There was an issue of long term impact for storing and evaporating water with high salinity. Again, the pits will be lined and we shouldn't see any impact as far as soil/water impact. Pond reclamation was an issue. We have had some discussion about this in the past. Pinnacle is going to pull the liners out of the pits and dispose of them off state land once the project is completed. Then it will be backfilled and thoroughly compacted. There were comments regarding treated water discharge which is a secondary management option that Pinnacle has proposed, and it is in the early stages of development now so they are not ready to go into a full field development. In the event they do decide to utilize that option the volume of water discharge is regulated by DEQ, they do have standards set in their existing permit for the quality of the water that is going to be discharged. The other comments received were air quality issues with the Decker and Spring Creek mines but it is also regulated by the DEQ. There were some general comments about erosion and noxious weeds. We have actually established operating and reclamation requirements on state lands to mitigate things like erosion and noxious weeds so we shouldn't see any problems with that at all. The final issue we have is the depletion of the water in the coal seams. With the water that has been depleted so far and what is anticipated to be depleted upon the CBNG development, less than 5% of the water in the coal seams will be removed for production.

Mark Deibert, Environmental Specialist with Western Land Services, said he was here on behalf of Pinnacle Resources to discuss water management. Basically what I am going to talk about are some of the things we look at from a holistic standpoint on how produced effluents can impact the state. The first thing we look at in developing a water management plan is regulatory requirements. These are state,

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federal, and local county regulatory requirements on how we deal with this effluent. We look at the different permits that are required from each of these governing bodies to ensure that we do not have any adverse impacts on the water or the land. Then we look at effluent quality, quantity, geographic considerations and other decision making factors. The different regulatory agencies we are involved with in this project are the EPA, US Army Corps of Engineers, Montana Board of Oil and Gas Conservation, Dept. of Environmental Quality, Dept. of Natural Resources and Conservation, local Conservation Districts and county zoning. These agencies are involved in determining whether a project can move forward for coal bed natural gas production. There are numerous permits we have obtained. Pinnacle currently has a discharge permit for discharge of treated effluents on the Tongue River and Storm Water Pollution Prevention Plan (DEQ permit) which protects the surface runoff and transport of suspended sediments into live bodies of water in the state. Looking at effluent quality, we want to ensure that the effluent produced does not have impacts on human health or domestic uses, animal health or stock and wildlife uses, and we want to ensure that no impacts occur to other aspects of the environment whether it is salinity, water, vegetation or soil impacts. Effluent quantity dictates the number of type of facilities we build, facility management, its placement, whether you are containing the water or whether you are developing outfalls, we look at trying to put all our infrastructure into one area disturbance and we also look at where the water is going to be discharged. Geographic considerations look at the topography, how steep or flat the terrain is. We do a watershed evaluation to make sure we don't have any long term impacts to the watershed. We look at soils and collect baseline soil samples to get a basic idea of what the preexisting conditions are. We also look at existing facilities nearby that we could incorporate into the project and look at potential erosion features. One of the most important other decision making factors is landowner needs and requirements. We work with the landowners to make sure their needs are met as well. We look at the regulatory limits and guidelines, and also look at project timing. The effluent management options are treatment and discharge, injection, reinjection, storage and retrieval, off-channel containment, evaporation, stock and wildlife watering. For treatment, basically what you're doing is taking the water and adding an acid resin to it, pulling the bicarbonates, carbonates, ions, sodiums, magnesium, calcium, and other salts out as a brine. The brine is then sent to a Class I injection well located in Wyoming and the treated water is then discharged into the Tongue River. One thing I want to note, 90% of the water is treated to a point better than what the state DEQ requires. They blend back 10% of untreated water to get to the DEQ's approved standard, then it is discharged. There is a slotted pipe that distributes the treated effluent evenly across the stream so you get instantaneous mixing of the effluent with the ambient water quality. The next option we looked at was injection, reinjection, storage and retrieval. The thing you have to look at is quality and quantity to ensure the effluent you are injecting does not have any impacts on the receiving aquifer. Next we looked at off-channel containment. Lined pits are commonly used throughout CBNG operation. There is an evaporator to be used on the lined pit. Other options include stock watering and wildlife watering. Pinnacle will obtain all beneficial use permits with the landowners if they choose to use the effluent. Management considerations are well placement, infrastructure design, wildlife surveys, cultural surveys, and monitoring requirements. Each one of the pits will have monitoring wells to monitor for leaks so the company will be able to pick up on any leaks immediately.

Mr. Morrison asked how long does it take one of these evaporation pits to fill up and once it is full what is its capacity as far as receiving additional discharge?

Mr. Deibert said as far as the effluent itself, it doesn't take too long for the pit to fill up. We've developed a water balance system. We know we are going to produce X amount of water, basically 600 gpm for the entire project, so then we develop a water management plan to make sure we can handle those effluents. Based on that, the four evaporation pits and the one storage pit can handle that effluent on an annual

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basis. If in deed, our production comes in higher, the operator can always modify the effluent production coming out of the well heads. That's one of the things in the water balance within the POD that shows during winter operations, they can back off production so natural and enhanced evaporation can keep up with the production.

Mr. Morrison said so for 600 gpm what you need is four evaporation pits?

Mr. Deibert said yes. Four evaporation pits and four evaporators per pit. Each one of the evaporating systems can process 85 gpm, the evaporation rate ranges during the winter from about 10% to 85% during the summer.

Mr. Morrison said then what you're left with is the liner with some sodium?

Mr. Deibert said basically, yes, a bunch of salts and solids. Right now we don't have a good idea as to what the exact water quality will be at this specific target formations. So we can't really gauge how much will be left over. As far as the disposal of this by-product, it will be disposed of in a state-approved manner whether it be an injection well or at a landfill.

Mr. Morrison said at the end of the process, what does the reclamation look like?

Mr. Deibert said let's start with the construction. The topsoil is stripped, the pits are constructed, the topsoil is then replaced and the site is reseeded. Then it is a reverse process from a reclamation standpoint. The topsoil is stripped off the dike, the liners are pulled, disposed of, the pit is actually reclaimed back to natural grade. The topsoil has been spread back over the site of disturbance and it is reseeded with an improved seed mix.

Mr. Morrison asked how long from the time the pits are constructed is it until you reach that point of the reclamation being complete?

Mr. Deibert said that is an unknown. I am not sure the operator knows what the life of these coal zones are going to be.

Mr. McGrath said just to clarify, I understood you to say that your company considers stock water use to be a beneficial use?

Mr. Deibert said yes, anytime we can provide water to the surface owner or the lessee we consider it a beneficial use to them.

Mr. McGrath said I am a little confused in terms of the permit from DEQ for discharge. I understand the plan is for evaporation pits but did I understand you to say you are already permitted if you end up having to discharge?

Mr. Deibert said yes, the Coal Creek pilot project has an approved discharge permit for that. Effluents currently being produced from eight different test wells, the effluents currently being processed and discharged through the treatment system go into the Tongue River. One of the options that the operator is looking at is incorporating additional wells or production into this existing facility. But there are a number of things, they are testing it to see if it is feasible to utilize the treatment process to handle the

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volume of effluents that could potentially arise as a result of all the wells coming on line and producing at a maximum rate.

Mr. McGrath said so the discharge permit you're talking about requires the water go through the treatment process? The discharge permit is a backup if the evaporation process doesn't work effectively, it would require the water be treated?

Mr. Deibert said yes.

Mr. McGrath said in terms of the treatment you talked about blending. Why do you treat 90% of the water?

Mr. Deibert said basically through the process at the treatment facility, as they are treating it, what they have found is that it actually treats it to a point better than that required by the state for discharge according to the permit standards and guidelines. So then what they do is blend in some non-treated water to get it to that point and then discharge the effluent.

Mr. McGrath said I understand that. But why not treat it better than is required?

Mr. Deibert said a lot of concerns they have is, for instance, there are concerns on the Powder River of discharging treated effluents that change the chemistry of the water. That is something that the standards of the DEQ has set. The operator then operates within that limitation.

Mr. McGrath said as you may know the Board of Environmental Review is looking at that, I think they have published proposed revisions to those standards. Is Pinnacle going to be able to comply with those if they are adopted?

Mr. Deibert said that is the decision that Pinnacle will have to make, I can't answer that.

Mr. Morrison asked who are you engaged by Mark, are you engaged by the agency or by Pinnacle?

Mr. Deibert replied by Pinnacle.

Governor Schweitzer said just so I have an idea of what this looks like now, I understand these evaporative ponds will use natural sources of evaporation during the summer months, during the winter we will have the emitters going so we can increase the evaporation?

Mr. Deibert said actually during the summer it will be a combination of both. The actual evaporation systems will be running 365 days out of the year so during the summer months you'll get rid of the majority of your effluent. During the winter, you will have to store large portions of the effluent and then based on ambient evaporation range and enhanced systems you can evaporate that which was stored during the winter plus what's being produced during the summer.

Governor Schweitzer said so for a 600 gpm treatment evaporation pond, what would be the size of that pond?

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Mr. Deibert said typically the ponds are roughly anywhere from 2.5 to 5 acres in size. A lot of it depends upon the topography. We try to place these, of course, off-channel but in an area that requires as little construction as possible to minimize disturbance.

Governor Schweitzer said and these emitters, how much do they increase the natural evapotranspiration from the pond itself? What is the multiplier?

Mr. Deibert said actually I am not sure what the multiplier is. For that area you can expect a natural evaporation rate of approximately four feet annually. So over a given area you are going to lose four feet of that head on the pond on a natural basis for an entire year.

Governor Schweitzer said so the evapotranspiration of that area during the summer months, during that 120 days, is more than an inch on average per day so that would give us to four feet of evaporation per year naturally?

Mr. Deibert said yes, approximately, according to the oil pan tests that have occurred in that area.

Governor Schweitzer said the multipliers of this is, is there some study on this so we would be able to say all right if you have a pan evaporation of one inch we could multiply that X amount with X number of evaporators?

Mr. Deibert said basically yes, what we do is look at a water balance on an annual basis. Actually we break that down on a month-by-month basis according to the pan test. They know they can get so many inches of evaporation per day and so we use that calculation to determine what the evaporation is per month. We then take that volume and subtract it from the total predicted production rate and then we know we'll have an additional effluent of X so we need to enhance that using the evaporation systems.

Governor Schweitzer said would you mind going through the math with us? There is 325,000 gallons in an acre-foot correct?

Mr. Deibert said 325,800.

Governor Schweitzer said so if we had for example, 600 gpm flowing in, how much water is that flowing annually? Governor Schweitzer said $600 \text{ gpm} \times 60 \times 24 \times 365$. I might be completely off, but I don't think we get 2.5 – 4 acres or anywhere close unless these emitters are multipliers of 10, 20-1.

Mr. Deibert said yes, actually according to the studies from the company that makes these evaporation systems, you can evaporate up to 85% of the total processed effluent. So for instance, if the evaporators can actually process 85 gpm, and 85% of that is evaporated, so that is roughly 70 gpm that is evaporating through those systems.

Governor Schweitzer said if we have a 2.5 acre pond, how many of these evaporators might we have, and how high do they shoot that water?

Mr. Deibert said they shoot approximately 10 feet.

Governor Schweitzer said and do we take into consideration prevailing winds so we know in the summer if the wind blows and when you squirt water in the air it sends it someplace else so we aren't actually

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going to be doing the land application in the area around it as we squirt that water. It is going to be contained in that?

Mr. Deibert said it is going to be contained within that. In fact each one of these evaporation systems will come with a gauge, basically the weather is gauged so when the wind speed gets to a point where it starts causing drift off of the actual evaporation pit site it will shut the system down. Also, each one of these pits will be fenced with a wildlife and livestock proof fence to ensure that livestock and wildlife can't get into it. And there will be drift fences, which are polyethylene sheets that will be hung on the leeward side of these ponds.

Governor Schweitzer said at the end of the day we are going to remove the liner and also the salt?

Mr. Deibert said yes.

Governor Schweitzer said I have to tell you based on my opportunities to review the good, bad and ugly of CBM in Wyoming last week, this off-site and off-channel evaporation is a good system. I like the sounds of this system. The systems they use in Wyoming is land treatment and on-channel. The on-channel they say is good up to a 24-month storm, so effectively what they are saying is they are planning to flush that system every 24 months. Of course, under those circumstances I am not sure they ought to even put a pond up, just run her down the creek and let her rip because it is going to make it there anyway. The second part they have is they do treatment and its remarkable, they pump it into a pond and then that pond goes out into a center pivot, oftentimes on a hill above the creek. So they are able to pump that back out on the earth and go outbound. They have a lot of sulphur and calcium sulphate and they are able to move those sodium salts into the root zone, below the root zone, so they are able to continue to grow crops as long as they are putting more water on it. The question is, what happens to that salt? Because now that salt is perched above where the stream is and it seems to me that salt will run with the water through time and it will run into a stream, the itinerant stream, and that stream will run into a creek and the creek will run it into the Powder River. I want to see the math because I want to see this work. If it fails, if the math is wrong, if 2.5 acres wasn't enough for 600 gpm or you produce more than 600 gpm and you fill it up at a much faster rate, what happens then? Do we apply to go on-channel storage, do we slow down production, or do we go to treatment?

Mr. Deibert said actually that is one of the things that is unique about a lot of these spots. We don't put all of our eggs into one basket so to speak. We use multiple tools and have those ready at our disposal. One of those is the actual existing treatment facility. Again, Pinnacle is just in the process of testing this. A lot of these proposed target zones they don't have an idea what the water quality and quantity will be. So its going to take some time to determine what exact method will work best. There are zones that have been found that have phenomenal quality water whereas others, lousy at best. So until that time, we want to ensure that absolutely no environmental impacts occur to the surface or waters of Montana, so we are totally containing this effluent with a liner, having it monitored, our groundwater wells, making sure no impacts or communication of the effluent with groundwater occurs until such time that we can determine water quality and quantity. This, Pinnacle feels, is the best option.

Governor Schweitzer said in Wyoming oftentimes there wasn't a single coal seam they were drilling to there would be 2, 3, 4, 5, 6, up to 8 seams. In some cases they drilled a separate bore to each seam and in some cases they drilled a single bore and they effectively mixed all the water and gas as they were extracting it. What's your situation here? How many seams do you have?

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Mr. Deibert said there are actually going to be seven seams but they are going to be dual completion, so there will be four wells per pad. There will be one well completed to the deep formation, one completed to the Smith-Anderson, one to the Cook-Otter, and another one to Canyon Wall formation.

Governor Schweitzer asked the most surface of these is how many feet down?

Mr. Deibert replied that I am not sure of, that is something the operator can determine.

Governor Schweitzer asked are these aquifers recharged? What does the hydrologic study say?

Mr. Deibert said I am more of a surface water person, but based on the information I've read, there is communication and recharge coming in laterally throughout these coal zones. So if you create a cone of depression you will have lateral movement coming in from the same formation but from outside of the actual area of drawdown.

Governor Schweitzer asked and is the drawdown the same on all of them? Are those interconnected drawdowns, if you drawdown zones 2, 3, and 4 and not 1?

Mr. Deibert said most of these zones within the Fort Union are independent of one another. I am not saying that all of them are, but from what I have read a large number of them are independent of one another, and there are geological structures and breaks that actually do separate these things. Theoretically, if they were interconnected and you draw down one, the lowest most seam or formation, you would start to see an impact or change in the upper seams as well. But to date they haven't been able to determine that.

Governor Schweitzer said if the surface user is using one of these coal seams as their stock water supply, and they lose their stock water supply, what are the ramifications of that?

Mr. Deibert said every landowner within a one mile area of influence has been offered a water well mitigation agreement as part of the requirements per the Board of Oil and Gas to ensure no impacts occur. If there is a domestic well completed to the same aquifer and there are adverse impacts as a result of methane production, the operator will then provide them an alternative water source. But to date based on our research of the Montana groundwater information system there are no domestic stock water wells on record completed to the same formation as Pinnacle proposes to produce out of.

Governor Schweitzer said many times I have looked at coal bed methane wells where they have electric pumps and you just about don't see them or hear them. Will you be using electric pumps or will you be using diesel or natural gas pumps?

Mr. Deibert said I believe they will be electric.

Governor Schweitzer said regarding the compressor stations. The ones I have found in Wyoming that work the best is where they found a geographic zone where they could put them into the depression because those are very loud. Obviously there will be compressor stations. Have you got some locations that will be in depressions so it will mitigate the sound?

Mr. Deibert said when an operator works with the landowner to design the project the landowner has a say in where the roads go, where the pipelines go, etc., that is one of the considerations they take is the

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compressor stations are basically out of sight, out of mind. They don't want to see them and they don't want to hear them. So, Pinnacle has worked with the landowner to ensure that they will not be impacted from either an audio or visual standpoint.

Governor Schweitzer said in the bonding process, the State of Montana is protected on those ponds you put on the state land. If your map is wrong and they happen to overflow or if we start discharging and the water is blown outside the plastic containment area, we are protected to clean that up or just solve it?

Mr. Deibert said absolutely.

Art Hayes, Jr., Tongue River Water User's Association, said while I am talking about the handouts, I will have my lobbyist set up the power point. The first thing you see in your handout is a USGS water study done in Wyoming. If you turn to the second page I have highlighted it uses trace element tritium to age this water. We can go back with tritium until 1952 because that is when we put tritium into the air when we shot the bombs off. You'll see that none of the Tongue River Member of the Ft. Union Formation which are the co-aquifers contains any tritium. This study was done in Wyoming and reviewed by a USGS hydrologist here in Montana. I followed up and asked would this be true that none of these coal seams contain tritium in this formation? He said it is the same formation and more than likely they have not recharged since 1952 or longer. That is as far back as we date it. This water is our most reliable source of water in SE Montana. I have wells in the same formations as the Coal Creek POD. To take this water and evaporate it I think would be a crime. This is our source of water, our main source of water. And it is a lot of the time better quality than our surface flows. There are other aquifers there but its time we look at the future instead of looking at one POD, one section, we have to look at the whole thing. We heard Mr. Deibert testify that there is natural recharge. But where is that recharge going to come from if we develop the whole thing? Sixty percent of the minerals in SE Montana are owned by the BLM, over 90% of those are leased. I don't think you could find a state section in the Powder River Basin that is not leased. Where is this recharge going to be? You look at Wyoming, it is massive. Montana is going to lose our groundwater because the flow from the Powder River Basin originates in Wyoming and comes to Montana. It flows south to north. So we have to look at that. I believe this is our main source of water, it is our most reliable source of water and we don't have to take all of the water from these aquifers before they quit drilling. I listened to a court case this summer, Diamond Cross Properties which owns land adjacent or on these Coal Creek-Dietz POD, they filed suit in District Court against Pinnacle, DEQ and the Montana Board of Oil and Gas. Their hydrologist gave the best example of you don't have to withdraw all the water. You go out into the surf and you gather a big handful of sand and you hold it there and water will run out. Pretty soon, its going to quit. Yet 80% of that water is still left in that sand. So you don't have to draw out a large amount of water and we do not know how much water is in these things.

The next water source that is really reliable that we can depend on, ranchers and farmers, to provide a very long term dependable source of water is the reliance on the Box Hills Formation. Diamond Cross Properties drilled a well into that and where they drilled it it was 2,500 feet deep. Due to the topography of the Tongue River area it would be anywhere from 2,000 to 3,000 feet deep. That puts it out of the economic reach of the rancher or anybody in agriculture. We need this water and to evaporate it, to discharge it, is wasteful. Another problem with this water is the sodium bicarbonate. Sodium bicarbonate is very toxic to aquatic life. And this sodium bicarbonate is a signature of coal bed methane anywhere in the world. Even the rate Pinnacle is treating it and discharging it into the Tongue River is toxic to aquatic life. This has been overlooked by the Board of Environmental Review and I think it is something we must consider. Would we allow this toxic water to be put into the Gallatin, the Flathead, or our blue

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ribbon trout streams? I don't think so. We have to look at aquatic life and fisheries. The Board has a duty to collect as much money to the state as possible out of these state lands, but you also have a duty to protect our waters. When you look at §85-1-101, MCA, it clearly says you have to do that. There is a conflict here. This is the conflict we are faced with as ranchers, are we going to have enough water in the future? Will there be enough water in the shallow aquifers? I talked to people in the klinker zones, where the coal has burned out, that is our best source of high quality water because it does not infiltrate down through the bad soils. We are losing our water, the drought is playing a horrible effect on our shallow groundwater. If you pull the coal bed methane waters out of these aquifers we're going to be a desert.

He presented a power point of the Tongue River Valley in Wyoming showing some of the land application and ponds. He said one of the creeks was dry and now has water in it, and asked where did that water come from? Is it coming from the ponds and infiltrating back into the ground? It takes a tremendous amount of area and the reclamation costs will be huge. These ponds are all unlined. You bring a lot of salts into the deep geological formations and deposit them on the surface. At the West Decker Coal Mine pit, there are discolored soils, alluvium soils. There is a great layer of clay soil above those coal beds, it has isolated those aquifers. You can see the water infiltrating into that alluvium, it is down so far and then it is going to move downstream. Downstream of these projects is the Tongue River and the Tongue River Reservoir where we have our contract water stored.

Governor Schweitzer said the power point shows what I was talking about in Wyoming. These are storage ponds and they accumulate the water and then it is pumped into an irrigation system. They will continue to irrigate them as long as we are developing the water. At the end of the day, it will still be irrigated down below but up on the top where they put that pivot it won't because there will not be water applied to it anymore. The farmer or rancher received 20 years of crop yields, the amendments they are using are large quantities of calcium sulphate and sulphur which is good practice, and the idea is to move the sodium as a salt out of the root zone which accumulates at 80 feet below the surface. What we've done is we've stored a great quantity of sodium that will act as a recharge repository of sodium that will ultimately flow down into that drainage, that drainage to the next drainage, that drainage to the Powder River, and the Powder River into Montana. Even though I've been told that this is a preferred treatment, it's not. I would actually rather evaporate it and store the salt than I would put it as a repository.

Mr. Hayes said I agree you're right, Governor. He showed a slide of the Tongue River Reservoir east of the proposed development. The klinker zone area is very poor, it can pass a lot of water quite rapidly. When we reconstructed the Tongue River Dam in 1999 there is a klinker zone between us and Decker Coal, we ran somewhere in the neighborhood of 20,000 gpm from the lake into the Decker Coal Pit. It dropped the Reservoir one foot. Any water leakage out of those lined pits is eventually going to hit this klinker zone and will come right down to the Reservoir. There is a fault line running through the lake and methane vents through the lake. Now we've got large areas in the Tongue River Reservoir that don't freeze in the winter. It could be hazardous for ice fishermen. There is a lot of methane. If they start pulling water off the other coal fields on the other side of the fault line, is that going to increase the methane venting in our state part? What is that methane going to do? We get horrible inversions, smog from the Decker Coal and Spring Creek Coal areas. We have some air quality problems in the area. There is a chemical treatment plant going in on the left abutment of the Tongue River Reservoir with a discharge point below some trees. It is not far from the river. We've had a history in this state of leaking ponds and if they are going to leak it will go directly to the river. You are barely able to dilute the water down. Fidelity will dump 2500 gpm into the river every year. We can't absorb that, and we can't absorb all the expansions without looking at the whole picture.

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Governor Schweitzer said I understand the concern and questioning whether the surface pool is recharged. That's why there has been discussion about the possibility of recharging discharge water to the surface zone. The coal bed methane operators tell me they believe this is a recharge zone and it is likely to recharge, and as Mr. Hayes suggested, it is likely to recharge from two miles over but if it is not a recharge zone, if they are wrong, do they have a legal bonded obligation to the landowner to drill a 2500 foot well and provide the electricity until whatever period of time the recharge occurs? If the answer is never, will they continue to provide the electricity for these wells that are now 2500 feet deep?

Mr. Hayes said Montana has a controlled groundwater area there and all it says is they have to offer you a water well mitigation agreement. That agreement doesn't have to be a good one. There are some that have been turned down. The one I have seen, they had 90 days to act to see if they caused it. Then another 90 days to drill a well. Have you ever tried to live a life for 180 days without any water? Its impossible. It doesn't say they will drill you a well, it says they will offer you a well.

Governor Schweitzer asked are these contracts bilateral in nature? They are a negotiated contract between the owner of the water rights and the coal bed methane company , or is it just a standard document and they say take it or leave it?

Mr. Hayes said one of my neighbors turned down Pinnacle's water well mitigation agreement. He came back with a counter offer and he never heard anything from them.

Governor Schweitzer said so what did they do? Did they go ahead and start developing or are they at an impasse?

Mr. Hayes said they started developing that Coal Creek pond within two miles from his house.

Governor Schweitzer said you mentioned the gas driven pumps, but Pinnacle said they would be using electricity in this area.

Mr. Hayes said for the compressors.

Governor Schweitzer said we saw several examples of unlined ponds that you showed us to demonstrate what the geology in the area was, I heard from Pinnacle that they are going to line them and there will be monitoring devices. If there is a leak they are obligated to fix that leak. Will that also be monitored by DEQ or is that monitored only by Pinnacle?

Mr. Deibert said it will be monitored by Pinnacle.

Governor Schweitzer said we are looking at 2500 cubic feet of flow and you made the comment that would be equal to what amount Pinnacle was going to be doing from this activity?

Mr. Hayes said is was Fidelity, Fidelity has a new application in to DEQ. They will discharge 5,000 acre feet of water per year into the Tongue River.

Beth Kaeding, Northern Plains Resource Council, said NPRC organizes citizens around the state to protect Montana's water quality and to protect the unique way of life we have in Montana. Many of our rancher/irrigator members will be adversely impacted by coal bed methane development in Montana's Powder River Basin as it is now proposed. As a member of NPRC's coal bed methane task force I am

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here today to ask the Board to simply delay action on Pinnacle Gas' resource Dietz POD. This is the 24 coal bed methane wells on state land. Northern Plains is not opposed to coal bed methane development but through our campaign of *Doing it Right*, we are committed to ensuring that coal bed methane development is done responsibly in Montana. We are committed to ensuring that the highly saline coal bed methane wastewater is not dumped into our waterways or onto our soils. Earlier this year, US District Magistrate Judge Anderson ruled that the 2003 Final Statewide Environmental Impact Statement (FEIS) for Montana for coal bed methane development was invalid because it failed to consider a phased development alternative, and thereby failed to adequately consider the impacts of coal bed methane extraction on SE Montana. The BLM is in the process of preparing a supplemental EIS on these issues, but Fidelity Exploration Company has appealed this decision to the 9th Circuit Court of Appeals. Meanwhile, the court has issued an injunction stopping all development on federal wells until they hear that case later this year. Closely tied to this legal action is another ruling this past June from Judge Anderson that the BLM violated the National Environmental Policy Act by attempting to rely on the analysis in the invalid FEIS for Fidelity's Badger Hills expansion project. I only mention these two cases to underscore Northern Plains' disappointment in how the State of Montana, despite these rulings, is proceeding with coal bed methane development without completely considering its impacts. To make my point, Montana's Board of Oil and Gas Conservation has been relying upon this same invalid FEIS to support its analysis of the environmental impacts of four recently approved coal bed methane projects that total more than 450 new wells.

In August, the BOGC approved Pinnacle's 48-well Coal Creek POD. The EA prepared by the BOGC does not take a substantive look at the potential impacts of this project. Their EA tiers to and incorporates by reference the invalid FEIS and it relies upon it extensively for its cumulative impact analysis. For wastewater disposal, Pinnacle proposed and the BOGC approved the use of eight evaporation and four containment impoundments and the method of land application and disposal, where wastewater is discarded onto native soils and vegetation. Unfortunately, the EA does not address the potential impacts of such impoundments and land application disposal operations on soils, vegetation, groundwater, or surface water resources. All of the 12 impoundments are located on a ranch whose attorney objected to the BOGC's approval.

In September, the BOGC approved the Pinnacle Dietz POD. The EA prepared is almost an exact "cut and paste" of the EA prepared for the Coal Creek project and is evidence to us that the BOGC did no site-specific analysis for the environmental impacts. The Deer Creek and Pond Creek PODs tier to and incorporate by reference the invalid FEIS and the invalid Badger Hills EA. NPRC will request the BOGC rescind its decisions approving these four projects until the validity of the FEIS is decided. We will also request the BOGC ensures that adequate environmental analysis for these project is complete. NPRC has successfully petitioned the Board of Environmental Review to examine how our state deals with coal bed methane wastewater. Our petition requests reinjection of wastewater or if not feasible, 100% treatment of the wastewater.

The NPRC is asking the Board of Land Commissioners to delay a decision on approving the 24 state wells in the Dietz POD until the final validity of the FEIS is determined, and until the Board of Environmental Review issues its ruling on how Montana will deal with coal bed methane wastewater. NPRC fully understands the Board's significant responsibilities for managing school trust lands. But as the new policy for the conservation and management of the state's school trust lands direct, you are committed to understanding all of the consequences of your decisions.

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Joseph Walks Along, Jr., Northern Cheyenne Tribe, said in reading the proposal and EAs and all the documents that came along with this, it concerns me that there seems to be a lack of consultation with the Tribe on all the issues here, air quality, water quality, permits, everything that goes along with the project. In looking back there has been a lot of litigation and court appearances and I don't think we have to go through that in the area of energy development. On a positive note we should try to keep a good positive relationship. The Tribe would like to continue that with the State of Montana and all your agencies involved. The Dietz project was a project that came up quick on the Tribe and I think they were not fully prepared to make their comments by the deadline and that is why I am here today, to make the comments for them. The Tribe has always been concerned about cultural resources. In reading the FONSI, the Finding of Non-Significant Impacts, there seems to be a lot of cultural resources in the area. That has been one of the sticking points on a previous project. We also had concerns about air quality. There doesn't seem to be any implements for additional air pollution, its been reviewed in court and there is not room for air pollution. The Northern Cheyenne Tribe is concerned because we are a Class I air shed within our boundaries. Not only that, we are concerned about the dust and all the emissions that could possibly come from compression stations and construction activities and impairing the visibility. We all like to see the land, especially down here in southeast Montana, its very beautiful we need that clean, pristine air. In terms of water quality, I've heard mentioned that this is going to be a bunch of ponds and storage facilities and they may fall back on the permit to discharge. Well, that concerns us. We are in the process of developing our reservation for the Tribe's water. The Tribe is a water right holder in the Tongue River and also has reserved water rights in the Tongue River Reservoir. So we are concerned about that. I think the government-to-government relation with Montana has been very good and we'd like to continue that. I hope that all interested parties in these projects come to middle ground somewhere to support everything, the environmental concerns and the energy concerns, so that we can move on and do things that are good for people in the State of Montana, the Northern Cheyenne Reservation, and all this area that's been talked about.

Governor Schweitzer said the site that is being proposed is east of the Northern Cheyenne Nation?

Mr. Walks Along said south.

Governor Schweitzer said Pinnacle said as part of their study they will do a cultural studies site assessment as part of this before there is disturbance?

Mr. Walks Along said I believe so.

Governor Schweitzer said does that satisfy the leadership at Northern Cheyenne that they will be doing this cultural study before they do any significant movement of dirt?

Mr. Walks Along said on the previous projects, they were federal projects, in reading the EA and the FONSI it sounds like this is more private land and maybe no access to them. So that does concern us. We'd like to work with them on middle ground.

Governor Schweitzer said as near as I can tell in terms of air pollution, Class I, that it is very limited amounts if they are going to use electric pumps so they won't be natural gas or diesel powered so there is limited amount of air pollution there. Do the compressors emit any emissions?

Mr. Walks Along said in some of the reports I've read, I believe there is.

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Dan Arthur, ALL Consulting, said we are a Department of Energy researcher, also contracted with the State of Montana, and I have worked with the BOGC on a number of research projects that were co-funded with the Department of Energy. He presented two studies to the Board. One of the studies is a primer on coal bed natural gas for the Rocky Mountain states, and the other one is a handbook on preparing and reviewing environmental and project planning documents specific to coal bed natural gas development and includes the regulatory information, i.e., water rights, drilling plans, surface use plans, mitigation agreements, and all sorts of different things that are done and some of the purposes behind them to complement some of the guidelines prepared by the BLM and the states. The State of Montana, in conjunction with the Department of Energy, has also done a best management practices handbook for coal bed natural gas to address issues such as air, noise, etc. In addition to a cooperative agreement with the State of Montana, the Department of Energy, BLM, and the Environmental Protection Council conducted with those groups as well as industry and special interest groups feasibility studies on produced water management specific to coal bed natural gas. As a result of the Governor's meeting in Wyoming last week, we were contacted by the Department of Energy this morning to conduct additional studies specific to additional potential alternatives for produced water management alternatives. We will be looking into that. We have these two documents and several others. Tom Richmond, BOGC, has the others on his web site and the information is available.

Brenda Lindlief-Hall, Tongue River Water Users' Association, said I commend Pinnacle and the information that was provided in the EA for at least mentioning reinjection. We are also happy to see that there is treatment of this water, or course we would prefer to see 100% treatment of the water and we'd like to see the water not discharged until it was treated to the quality of the tributaries or the surface water it will be discharged to before coal bed methane development started. In other words, we'd like to see it treated to baseline before being discharged. We do agree that the EA that was done here and for Coal Creek POD adhered to the FEIS that at this point is unlawful. The EA that has been prepared for these projects because they tiered from that document, we feel is not lawful and that an adequate environmental analysis has not been done.

Mr. McGrath said Ms. Coughlin, would you please address the comments Ms. Lindlief-Hall made on the validity of the EIS? It is my understanding that this area is not part of the court injunction. But could you explain this?

Ms. Coughlin said Judge Magistrate Anderson actually has invalidated the EIS for federal actions, it has not been challenged for state and private actions. As a result, the BOGC tiered off of that EIS for their EA, we did not directly tier off the EIS for ours, we tiered off of the BOGC's EA which covered all 161 wells for the whole project.

Mr. McGrath said on this discharge issue, I understood you to say that if the evaporation process doesn't work and they have to discharge, they will be subject to getting a permit and I understood Mr. Deibert to say they had a permit or it comes under an existing permit. Can you clarify that?

Ms. Coughlin said they do have an existing permit for 1122 gpm. It is with DEQ right now for their Coal Creek pilot project. If they decide they want to utilize it for this project as well, they have the capacity to do that under the existing permit, however, I believe they would have to get a modification of the permit to include the lands covered under this project as well.

Mr. McGrath said and the folks of Pinnacle are nodding their heads. So you concur that you would have to go back and modify the permit.

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Governor Schweitzer said would you in layman's terms describe to me what the answer to the first question was?

Mr. McGrath said as I understand it, the BLM did an EIS on the whole area development and that has been determined to be invalid because it didn't look at phased development and possible alternatives. There have been some exceptions issued by the court itself in terms of some existing projects so they can go ahead and proceed. The state Board of Oil and Gas Conservation did a separate study. They didn't do an EIS, they did an EA on more or less the same area and the department is basing their results on the separate EA that the BOGC did. Monte would you clarify that please?

Mr. Mason said I would just correct you, Mr. Attorney General, to the extent that the Programmatic EIS is a joint EIS prepared by BLM, BOGC, and DEQ. The federal decision that we've been talking about did invalidate the EIS based on phased development and some other federal issues. The Record of Decisions were separate. BLM issued a Record of Decision (ROD), the BOGC, and DEQ for their part. The decision by the BOGC based on a Programmatic to implement that has not been challenged. It is valid as we sit here today. Legally, they are entitled to tier off information they helped prepare.

Mr. Johnson said I appreciate the folks that have spoken today and taken the time to come and lay out their respective arguments but when all is said and done, do you see any information that was presented here today to suggest that this Board should have the department revisit the ROD that you signed off on?

Mr. Mason said I do not. There was some comment about apparent plans to go to the BOGC to possibly challenge some of the decisions they have made. They mentioned a few of the PODs not just this one. As we stand here today, I am not aware of any challenge to the POD that our portion is part of that we are looking at today. So, as of right now if nothing changes with the BOGC the wells around us, the 130+ wells on private land, will be developed. They have legal permits to do so. We are here today talking about our 24 wells surrounded by the wells on private land. If there were a challenge that the BOGC felt inclined to withdraw their APDs on this one, they regulate us, so then none of the wells would be drilled. The decision we have here today puts our wells in play on equal footing with private wells that are already permitted. If for some reason the BOGC were to make a change, there is no need for us to delay because that would take place pursuant to their regulatory board. But nothing of that sort has been submitted to the BOGC as far as I am aware. And neither have the previous ones as well.

Mr. McGrath said there was also concern that the Board of Environmental Review may be changing its standard, or at least there is a petition for them to do that. As I understand it, that won't affect this project because the request preceded any change.

Mr. Mason said that is correct.

Governor Schweitzer said it probably wouldn't affect this one anyway because those were on degradation standards. I guess the first part of it would, which would force reinjection, but the non-degradation standards wouldn't be affected because this plan of action is not to apply the water back into the river and if you do, you would treat it first. I think I understood their treatment levels would bring us back to less than the natural ambient level. They would have to bring the levels down below what has been the natural state of the river. Is that what your treatment would be if you went to a treatment system?

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Mr. Deibert said they have a non-degradation requirement in there and you can't degrade it any worse than it is.

[State Auditor John Morrison left the meeting at this time.]

Governor Schweitzer said it is at 100% currently and the proposal of non-degradation would take us to 50% as I understand it. Let me suggest something to the Board, we have two of our Board members that are not here. John Morrison had to speak/teach at the law school and wasn't able to continue to be part of the full debate here and have an opportunity to review this. I know Linda McCulloch has the opportunity to vote but this is complex and I am going to make the suggestion that we delay the decision on this until we have at least four of the Board members present to make this decision. Is that something that the two of you would consider?

Mr. McGrath said I think that is a good idea. Motion was made by Mr. McGrath to delay this decision until next month. Seconded by Mr. Johnson. Motion carried 4-0.

1005-11 RIGHTS-OF-WAY APPLICATIONS

We have a number of historic applications, several new ones, and ones of interest to wetland application from the Department of Transportation. It is a mitigation on state lands. Ms. Sexton suggested the Board address the rights-of-ways as a package. This month there are 63 applications, they are #12203 through 12207 from Triangle Telephone for buried telephone distribution lines; #12811 through 12815 from Sheridan Electric Coop for overhead telephone distribution lines; #12873 and 13610 from Montana Department of Transportation for a wetland mitigation site; #12986 through 13995, 13031 through 13039, 13060 through 13065 are from Sun River Electric for overhead powerlines; #13249, 13251, 13253, 13255, 13257, and 13609 are from Three Rivers Communications for buried communications cables; #13528 from the City of Scobey for access to city wastewater treatment facility; #13550 from Richard and Robin Street for a private access road to a single family residence; #13603 from Naylor Family Trust for a private access road for conducting normal farming and ranching; #13604 from Northern Telephone Cooperative for a buried communications cable; #13605 through 13608 from Twin Hills Colony for buried 8" water lines; #13611 from the Williston Basin Interstate Pipeline Company; and #13612 from Elsie Gress and Bruce and Roxanne Street for a private access road to a single family residence.

Motion was made by Mr. McGrath to approve the package of right-of-way applications. Seconded by Mr. Johnson. Motion carried unanimously.

INFORMATION ITEMS

Ms. Sexton said we do have some informational items but in the interest of time I am going to suggest the Trust Administration Costs as well as the State Forest Land Management Plan implementation monitoring report be delayed until next month.

~~1005-12~~ ~~TRUST ADMINISTRATION COSTS~~ -Deferred until November

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1005-13

WHITEFISH COMMUNITY PLAN IMPLEMENTATION

Ms. Sexton said this information is for the implementation of the Whitefish Plan. Last month the Board approved the proposal process and given that process we did receive letters from the community of Whitefish and Flathead Gateway Partners. There were letters of interest in developing a recreational trail on the trust lands area in Whitefish. We have a number of non-profits and individuals who are working under the auspices of the City of Whitefish as well as the local development corporation in implementing much of the Whitefish Plan beginning first with the Whitefish Trail System. This is a very promising and progressive approach to the Whitefish Plan implementation.

Representative Mike Jopek, Whitefish, said Senator Weinberg, Mayor Feury and myself got together and decided that it was time to start implementing aspects of the Whitefish Plan. The Plan was adopted by the Board, Whitefish, and Flathead County as part of our growth policies. That Whitefish Plan calls for recreation, conservation, and limited development on some 20 sections of state land surrounding Whitefish. The letter you have before you is from the City of Whitefish indicating their interest to become a lead advocate. The second letter is from a non-profit from Whitefish interested in joining in that collaborative process. Whitefish has really become a landmark community for creating these private/public partnerships, leveraging private dollars to create good opportunities for the public in our community. The third piece of literature in your packet is the opening statement by the Whitefish City Attorney outlining the Memorandum of Understanding (MOU) that is going to be up for discussion today by the City-Council. As you'll notice from the City Attorney's comments, this type of collaborative partnership in the state endeavors is really a first for Montana. The Whitefish Neighborhood Plan was adopted and was the first time to that scale Montana had entered into a collaborative planning process. This could become the first time the State of Montana would enter into this type of endeavor with a public/private partnership and it offers tremendous opportunities for both the trust as well as the community. The Plan looks at doing some 100 miles of recreational trails surrounding Whitefish. It goes from Spencer Mountain around Whitefish Lake to Beaver Lake, up the Big Mountain and down the Big Mountain to the Haskill basin area all the way to Happy Valley and circling back around to Spencer Mountain. Once you do provide these type of economic incentives, what you'll find and what other communities have found, is people travel for thousands and thousands of miles to take opportunities in these public places. In conjunction with that trail system is the objective of conservation. It is conserving the traditional use lands associated with that trail and that becomes the second segment of the MOU which will be the fourth segment. The city proposes to enter into a partnership with a non-profit entity called Flathead Gateway Partners. The city is interested in implementing a two phase approach looking first at the recreational trail aspect and then some conservation aspects associated with that trail. Both of these elements are specifically called for in the Whitefish Plan so we are very consistent with the Neighborhood Plan that has been adopted as well as doing right by the community. The MOU creates a first for Montana in that direction, it creates a steering committee which will be two city representatives, two non-profit representatives, and the steering committee will operate with the assistance and consultation of a stakeholders group. That stakeholders group would be comprised of recreationalists, trust land lease holders, landowners along that particular trail, members of the public at large, representatives of neighborhood associations, representatives of local government, representatives of state Fish Wildlife and Parks, as well as representatives of DNRC. Our hope is that by being able to work together through these complex issues we will come up with a plan for the trail system which the community, the agency, can buy off on and we'll be able to provide those much needed dollars for our schools as well as honor the obligations of the Whitefish Plan. The next document before you is articles from the local newspaper to be looked at your convenience. The challenge we have before us is how do we bring like-minded folks together to honor those recreational conservation values we hold so dear. We

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believe we can do that and as we get to the implementation phase we ask that you have faith in us to be able to do that.

Diane Conradi, Flathead Gateway Partners, said this "*trail runs through it*" project people are fired up, we have a lot of support and great ideas coming forward. It is a pleasure to be able to work on a project like this. I've advocated a collaborative process for the state lands planning process and I think it was successful. We're talking about applying that model to some degree in establishing an advisory committee. Flathead Gateway Partners was formed in 2004 and the idea behind it was to help people put their good ideas to work. Folks have good ideas and they might not need to form a corporation or non-profit and so we helped them put their ideas to work on the ground in ways that conserve the values we cherish in the Whitefish area. So far, the Flathead Gateway Partners worked with the advisory group to fund the consultant we used to develop the Whitefish Plan's process. We sponsored a survey of the collaborative process that took place in Whitefish to see if participants and the community were satisfied with how the process went and what the outcome was. Now we're taking our involvement the next step and our primary work will be to raise funds to support this project not just in the trail planning process but in the construction and probably most importantly the maintenance and management of the trail system. We will also take on the role of managing this project, trail management.

Mr. McGrath said what are you anticipating the timeline will be if the local groups get together and bring something to us?

Ms. Sexton said we have to go through the process that was outlined last month, we have to get an initial application and then we will review the application in terms of the Whitefish Plan and how it fits also with depending upon what approach they want to take for the land use license. Then we will propose how this transaction will occur and what partners might be involved so my guess is by the time we really look at, the trails have to be surveyed and whatnot, I would say five to six months.

Representative Jopek said that timeframe is very accurate. The steering committee that is formed by the public/private partnership will be getting together with the agency to do that initial scoping process. After that the advisory committee gets together this year and we all currently anticipate that the five to six month time line is when we are hoping to have the trail aspect portion of this project completed. Some of the conservation objectives might run much longer as spelled out in the Whitefish Plan.

1005-14 — ~~STATE FOREST LAND MANAGEMENT PLAN IMPLEMENTATION~~
~~MONITORING REPORT~~ Deferred until November

1005-15 BRENNAN'S WAVE

Ms Sexton said this was brought up last month and is an effort by a group of people in Missoula who have been working with the Orchard Home Irrigation Company to replace an aging dike in the Clark Fork River. It is very close to the carousel the Higgins Avenue bridge. This structure that would be put across the river is a wave for kayaking and this group has been raising funds and working with the county and the irrigation company on this project. The county issued a 310 permit on Friday. The county issues the permit because the conservation district did not have jurisdiction. We have received an application for further permitting and an acknowledgement of dual purpose. We have analyzed the request for dual purpose being it is for both irrigation and recreation and we are proposing an interim Land Use License.

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A Land Use License would allow for construction and placement of this feature in the river, this License will be for three years. The department is contemplating a transfer, what we call a 351 transfer, to the City of Missoula, who is the appropriate holder of this. We have reduced the amount of this Land Use License considerably to 1% of the actual value, it will be \$380 annually. We are also requesting further agreements with Brennan's Wave and Orchard Home Irrigation Company that there be liability insurance as well as bonding for this project for a term of this interim Land Use License. This is an unusual as well as the first of its kind project and we are looking at this to see what kinds of options are available to us in other areas. It is our hope that for this and in the long run when other project proposals come to us that we can be in partnership with local municipalities, local governments, so there is an entity that takes responsibility for this.

David Guth, Physician, said I am both humbled and honored that this proposed project will be named after my son. My message is that for us time is of the essence. This is a structure in the river below the Higgins Avenue bridge and it is a fully legal irrigation weir and that function and capacity should last 50-60 years. The current weir is broken down and is now a water hazard and an eyesore. My son had a vision that repair of this weir be a more appropriate feature, the structure will be a better way to solve these issues. It will be aesthetic and structured primarily of natural boulders brought into place and will be safe. As well it will be the final piece in place in Missoula's urban river corridor coexisting beautifully along our riverfront park, our walkway, the carousel, Dragon's Hollow, and a skate park. It will be a nice urban corridor there. There is no opposition to this project. We have full support from the community and have passed every regulatory statute to accomplish our goal. This project has taken over three years, construction needs to begin in the next 60 days or so as the water is now low and will be low for the next five months. If we cannot build we will lose the season and more importantly we will lose the \$175,000 in money from the Missoula Redevelopment Agency which sunsets in June. We realize that your primary concern is the presence of liability and we know your intention is to help us and we appreciate that. The general concept is that Brennan's Wave is related to a whitewater park and in a way it is but it really is not. This is just a single roller wave about 18 inches drop, no higher than the current structure. It will have no reverse or retract features, it will be done by a well-known river engineer, one that has designed whitewater parks around the country. This structure will be a safety benefit for everyone, rafters, canoeists, fishermen, kayakers, and inner tubers and will provide safe fish passage. This is in stark contrast to the structure that is in place now. The preexisting unattractive weir has shown itself over a period of time to be an extreme water hazard. We feel that our non-profit volunteer group has worked very hard over the last few years to address the issues of liability and we feel mass improvement in the existing conditions in the hope as we go through this. In very simple terms Brennan's Wave will repair the existing structure and it is much safer than what is there now.

Mike Munsey, Missoula, said in Missoula public area is different than it is in most places and in all the years I've been in Missoula I've never seen a project come through the city that has had no opposition, there is great public support for this project. We have raised \$100,000 in private funds, we have \$175,000 pledged from the Missoula Redevelopment Agency and one of the other sticking points in moving forward with this project is going to be assistance from Envirocon, a company that is going to clean up the Milltown Dam. They are the company that is going to build this weir for us and they are going to do it at a very reduced cost. That is their contribution to the project. Obviously, when they start Milltown Dam they will not have the time or the resources to do this so we submit that we need to get this on track as soon as possible so we can complete it this year. When you stand on the Higgins Avenue bridge and look west, what you see down in that river are some big chunks of concrete. I liken them to the old days in Montana where people threw junk cars in the rivers. In my estimation what we're doing is taking the junk car out of that river and we are going to replace that weir, which Orchard Homes has no legal

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obligation to fix, and we are going to fix that and replace it with something that is going to have tremendous recreational opportunities. The positive benefits are overwhelming and we request your help in getting this done.

Dave Dalthorp, Missoula, said I think it is a great idea. They are removing an existing hazard. There has to be something in the river for the irrigation diversion, there is something in the river, and they are going to put in something better that will be safer. What this does is balance a beneficial use, irrigation, and a second use is public benefit which is water recreation. There is a whole host of statutes in Montana that favors these things and this is a good way to go about it. On my own behalf I will say I am one of those kayakers who goes in and benefits Missoula's economy on certain occasions and I will tell you that I know I and other kayakers who go to Missoula will benefit the economy more with Brennan's Wave.

Governor Schweitzer said I have been following this and Mary and I have had many conversations about it. It looks like things are moving along nicely. The question of the liability and maybe some bridge funds to get to the point where the city will take over the liability is the only thing we need to get addressed in the short term. The rest of it I think you are moving along quickly.

Mr. Dalthorp said as far as liability I know the existing structure looks bad and dangerous. It seemed to be more of a liability hazard than what is being proposed, this smooth Class I to II wave.

Governor Schweitzer said as you know when I say liability it usually means a situation where we are looking for the deepest pockets and if the State of Montana is involved in this in any way we automatically become the deepest pocket. Its just a question of making sure the resources are there to pay liability insurance, \$5 million, and given the community's support for this project I think this is very doable.

Mr. Dalthorp said I see that that \$5 million figure has been put out there but as I understand it there is a \$750,000 cap on any of the state's liability. That would be something more to be brought up in letters.

Mr. McGrath said we do have to look at the cap, and there may be a way to reduce that. It is a significant hazard now and this should improve that. We want to make sure that what we do is not inconsistent in other areas. I have talked with the attorney involved in this project. We have significant litigation going on in terms of Montana's rivers and we want to make sure we don't do anything here that jeopardizes those proceedings. I think we can worked out. Mary, how long, time-wise, on this one before it comes to the Board?

Ms. Sexton said at this point we don't have to bring it to the Board. We can finalize this as long as the terms of are in agreement to both sides because this is less than \$50,000.

Ms. Sexton said before adjournment, I want to make sure your intent at the next meeting, the November meeting, is to bring forward the Pinnacle Gas Dietz well drilling application?

Governor Schweitzer said yes.

Motion to adjourn was made by Mr. Johnson and seconded by Mr. McGrath.